

## Overview

This Guideline sets out the approach of the adidas Group Social & Environmental Affairs (“SEA”) Department to enforcement of the adidas Group Workplace Standards (“Standards”). The first part of the Guideline explains the principles by which we make decisions in relation to enforcement of the Standards. Part 2 provides the definitions of Zero Tolerance and Threshold Issues, i.e. those cases of extremely serious non-compliance which would trigger enforcement actions that may impact a supplier’s business. Part 3 of the Guideline sets out the range of enforcement actions, i.e. those ‘remedies’ available to the adidas Group where a supplier is unwilling or unable to comply with the Standards, and the process for applying such remedies. Part 4 sets out some additional definitions and notes regarding the updating of this document. Accompanying this Guideline is the Enforcement Guideline Procedure Flowchart which maps out the process of investigation, remediation and enforcement, and the parties involved in that process.

## Part 1 – Principles

The SEA Team believes in firm but fair enforcement of the adidas Group Standards. Underlying a policy of firm but fair enforcement are the principles of:

- *proportionality* in the application of the Standards and in ensuring compliance with them;
- *flexibility* of approach by SEA towards all Business Partners and across all regions;
- *transparency* in relation to how the SEA Team operates and how the Standards should be implemented, i.e. providing clear information about what our Business Partners may expect from us and what we in turn expect of them; and
- *targeting* appropriately the recipients of any sanctions or other enforcement action.

### 1.1 Proportionality

The concept of proportionality requires that any action taken to protect workers, the environment or the adidas Group brand must be balanced against the risks and costs associated with that action.

Breaches of the Standards, in particular those relating to workplace health and safety, may cause or have the potential to cause serious risk of injury to factory workers. Other breaches of the Standards may interfere with worker rights, or may adversely impact the environment. The SEA Team’s first priority is to prevent harm to workers or the environment from occurring and to ensure that such harm does not continue. Any action taken by the SEA Team will be proportionate to the risks posed by, and the seriousness of, the breach of the Standards.

### 1.2 Flexibility

The SEA Team aims to achieve consistency in the advice we provide to Business Partners about the Standards and our responses to any non-compliance with the Standards. This requires us to adopt a similar approach in similar circumstances where the Standards have been breached in order to achieve a similar outcome – the outcome being protection of workers and the environment through compliance with the Standards.

However, the SEA Team recognises that consistency does not mean simple uniformity. We need to take into account many variables, such as the scale of the non-compliance, the attitude and actions of factory management, and any history of previous incidents or breaches of the Standards. Any decision to take enforcement action against a Business Partner, for example to issue a stop work notice or recommend termination of the manufacturing agreement, is a matter of professional judgment, and the SEA Team will exercise its discretion in this area, in consultation with our colleagues in Operations.

### **1.3 Transparency**

Transparency is important in maintaining confidence in the SEA Team. Business Partners who want to comply with the Standards need to understand what is expected of them and what they may expect from the SEA Team in return. It also requires that the SEA Team provides clear reasons as to why any action to enforce the Standards is necessary, and that the action itself is clearly communicated to Business Partners and our adidas Group colleagues.

Transparency is essential to the conduct of the SEA Team. The adidas Group provides ongoing training to the SEA Team and continuously reviews and develops the Team's procedures to ensure that:

- 1) where a factory does not comply with the Standards and remediation is required, it is clearly explained why the steps outlined in an action plan are necessary and must be carried out – a distinction being made between implementation of best practice and meeting minimum compliance requirements;
- 2) opportunity is provided to the SEA Team and Business Partner to discuss and clarify the requirements before any remediation steps are taken – unless urgent action is required, for example to protect workers from serious danger or to prevent extreme environmental damage; and
- 3) where urgent action to enforce the Standards is required, a clear and complete written explanation of the reasons will be provided.

### **1.4 Targeting**

Targeting means making sure that any enforcement action is directed appropriately at those primarily responsible for the breach of the Standards, and is focused on those areas which present the greatest risk or are the least well-controlled. Ultimately it is our Business Partners who are directly responsible for the risks at their manufacturing sites and who are best placed to control those risks.

The SEA Team has systems in place that help us to prioritise and respond to risks as we become aware of them. They include:

- 1) methods for responding to complaints received directly from workers;
- 2) conducting an assessment of the risks to worker health & safety and the environment posed by the manufacturing operations within a facility;
- 3) reviewing the management systems within a facility which regulate human resources practices and industrial relations; and
- 4) acting on the independent reports of third party auditors and monitors.

In all cases, the attitude of management and the actions it takes (or fails to take) to promote compliance with the Standards are of critical importance. Repeated incidents or breaches of the Standards may be an indication of an unwillingness to comply with the Standards, to change unacceptable behaviours, or an inability to achieve sufficient control. This may require a total review of the relationship with the Business Partner, and in order to continue doing business, considerable investment by both the adidas Group and the Business Partner.

## Part 2 – Defining Serious Non-Compliance

In the course of monitoring the facilities of our Business Partners, the SEA Team regularly uncovers breaches of the Standards. In most cases, such incidences of non-compliance are not so severe in nature as to require sanction. Normal practice for the SEA Team is to issue an action plan setting out negotiated timelines for factory management to resolve any breaches of the Standards which are not considered severe or place the business partnership at risk.

On other occasions, the breaches are more severe and may threaten the lives or well being of workers, suppress fundamental human rights, or result in irreparable damage to the environment. Part 2.1 below provides an explanation of those items we treat as Zero Tolerance. Part 2.2 lists Threshold Issues, i.e. those types of breaches or workplace issues which are considered to be extremely serious in nature, requiring enforcement action to be taken against existing suppliers.

### 2.1 Zero Tolerance

Zero Tolerance issues are those items with no opportunity for remediation. This means that identification of any Zero Tolerance at an existing supplier will automatically trigger a termination process. In some cases, this may result in termination of the factory only. In others, it may result in termination of the supplier, including all its facilities.

There are three Zero Tolerance categories:

- 1) **Prison Labour** – Includes any form of manufacturing, whether ‘illegal’ or ‘unauthorised’ or part of a legitimate work programme, conducted within the confines of a prison, or by prisoners who have been sent to the manufacturing site, regardless of whether the prisoners are paid for their work.
- 2) **Critical, Life-Threatening HSE Conditions** – A factory site is structurally unsound and may collapse (either partially or completely) causing serious injury or death – this may be determined by lack of engineering certification, or by resemblance to other collapsed structures. An immediate and serious fire hazard is present, such as a large quantity of flammable chemicals or materials placed on site without any proper control system in place. Any other set of circumstances which may cause danger or life threat to visitors/auditors.
- 3) **Repetitive and Systematic Abuse** – The abuse may be sexual, physical or mental in nature, and must form part of the management style of the supplier, i.e. must be part of the day-to-day management of the factory. For example, physical punishment is used to discipline workers; workers are regularly locked inside the factory and unable to leave; there is widespread sexual harassment of workers. Systematic abuse would not include isolated

actions, criminal acts, or one person who abuses power; all such cases can be remediated by management.

## 2.2 Threshold Issues

Threshold Issues have a higher priority than other items listed in a corrective action report. If an existing supplier is unable to resolve items on this list on a priority basis, then it will be subject to enforcement actions. Those items identified as 'threshold' are:

- 1) **Deliberate Harassment of Unions** – The harassment may be physical or mental in nature, but usually consists of persistent discrimination against the officers or members of a union. It may occur during the recruitment process or form part of the management style of the supplier in its day-to-day running of the factory. For example:
  - a) Supervisors are either allowed, or instructed, to harass union members or officers through use of abusive language, allocating 'dirty' jobs, rotating between departments, or passing over for promotion or other rewards.
  - b) Interfering with union activities or preventing access to members and workers by the union.
  - c) Punishing workers or union members for joining a strike.
- 2) **Excessive Overtime** – Excessive overtime means:
  - a) more than 60 hours per week as a general practice; or
  - b) missing rest days, such as consecutive Sundays worked without compensatory time off at least half of the previous 12 months,

for any individual production line worker *excluding* drivers, security guards, office workers, and workers in special areas such as the warehouse or sample room, in which case 72 hrs is the allowable weekly maximum, subject to local legal requirements.
- 3) **Non-Payment of Wages - TIMING**  
Wages normally must be paid within 7-10 days of the end of the last pay period. Failure to do so is considered a breach of the Standards, requiring remediation by the supplier. Non-payment, for the purposes of defining Threshold Issues, means failure to pay workers:
  - a) within 30 days of the end of the pay period; or
  - b) within the amount of time specified by local law if less than a) directly above, more than once within the previous 12 months.
- 4) **Non-Payment of Wages – AMOUNT**  
Suppliers must pay wages in full. Partial payment of wages will be considered as non-payment of wages. For the purposes of this Threshold Issue, Wages includes the following standard items of a worker's wage package, i.e.:
  - i) the monthly minimum or basic wage (basic wage may be higher than the local legal minimum wage);
  - ii) all overtime payment due to the worker for the pay period,
  - iii) all *fixed* amounts, for example technical allowance, seniority allowance, meal allowance, night shift allowance, hardship or position allowance; and
  - iv) any *non-fixed* amounts which are calculated based on the productivity or output for that pay period, for example a monthly efficiency or productivity bonus which is provided based on the performance/output of the worker's unit or the individual worker.

Wages does not include any discretionary bonuses which management may provide workers from time to time, based on the financial performance of the factory or local custom.

- 5) **Fraud & Exploitation** – Double book-keeping or other fraudulent practices in evidence. Such practice may have evolved because it satisfies other customers' requirements. However, after gaining an understanding of the adidas programme, such action would not be tolerated. If production records or other documentation, investigation of the workplace, or interviews with workers or other factory staff reveal falsified records, management must acknowledge and correct the documentation systems. Management cooperation will also be judged on the level of transparency provided to workers. For example, workers must be allowed to see their complete hours and pay records.
- 6) **Management Attitude and Systems**
  - a) The attitude of the factory management is so poor that the SEA Team believes there will be nil or minimal cooperation on the part of the supplier in any remediation process. It must form part of the management style of the supplier, i.e. it is not a problem of just one or two uncooperative members of the management team. For example, the owner or general manager tells the SEA Team that the factory refuses/will refuse to comply with the Standards, or members of the management team consistently lie to the SEA Team throughout factory visits or in general communications.
  - b) The systems are so poor as to be beyond remedy. There is a complete lack of commitment from management, and no sense that any further improvements will be made in good faith. For example, management may indicate that it has absolutely no capacity or willingness to implement systems that will help manage the workforce and supplier compliance.
- 7) **Other Serious Labour Problems** – Including:
  - a) no time recording system, or one that is not verifiable (e.g. worker signatures are accepted as means of verification);
  - b) no accident insurance, health insurance, or any other legally required benefits;
  - c) no payment records, pay system, or undocumented practices, such as workers being paid 'off-the-books';
  - d) failure to implement minimum wage and proper overtime or holiday rates;
  - e) no personnel files or worker records system;
  - f) withholding original worker documentation without worker access;
  - g) no proper age documentation on personnel files;
  - h) failure to manage existing child labour problems;
  - i) juvenile workers in hazardous positions;
  - j) use of apprentices or trainees with pay below minimum wage;
  - k) fines or monetary penalties used as a form of discipline;
  - l) deliberate discrimination based on protected class; or
  - m) retaliation against workers who report problems.
- 8) **Extremely Poor HSE Conditions** – Including:
  - a) poor fire safety practices, including:
    - i. no evacuation drills within the last 6 months;
    - ii. no, or minimal, functioning basic fire safety equipment, such as an alarm system and fire extinguishers;

- iii. no, or restricted, means of escape in the event of an emergency;
  - iv. no, or minimal, or extremely poorly designed, emergency lighting, exit arrows and other signage necessary to assist evacuation in an emergency; or
  - v. very poor housekeeping practices or electrical installation which creates a fire hazard.
- b) use of banned chemicals or restricted substances;
  - c) no, or very minimal, protection (such as personal protective equipment, ventilation or extraction systems) provided for workers who are exposed to hazardous substances, such as VOC or toxic dust;
  - d) use of high risk machinery, with the potential to cause major injury or result in fatality, which is insufficiently safeguarded or lacking in safety devices, e.g. sensors or emergency stop buttons;
  - e) lack of safety controls or other precautionary systems in high risk working areas, such as the boiler and power plants;
  - f) warehousing, production facilities and dormitories are all in the same building; or
  - g) operations have significant detrimental consequences for the environment, such as no waste water treatment in the dyeing or laundry facilities;

### **2.3 Denial of Access**

This occurs when the SEA Team, third party monitors, project partners or consultants are refused entry to the facility, access to documents, or permission to interview workers. All of these activities are required for monitoring of the workplace. If management does not permit such activities to proceed, then the factory is obstructing the work of the SEA Team. In rare cases, an emergency may genuinely preclude access, such as a strike or natural disaster, and in such instances the factory would not be penalised.

Denial of access is considered to be an extremely serious problem. As such the obligation to provide free and unobstructed access to the adidas Group SEA Team and third party monitors is included in the manufacturing agreement. Therefore, denial of access will be treated as a legal issue and not necessarily a compliance issue. Where SEA Team members are denied access, this will be reported to SEA Management, who will discuss appropriate actions with the Legal Department.

## **Part 3 – Enforcement Actions**

This section sets out a variety of ‘remedies’ which the SEA Team may rely on. In all cases, the SEA Team will consider what impact such action(s) may have on the workforce, and will aim to balance this against the need to introduce sanctions or take other enforcement action. The remedies are to be applied on a case by case basis, and are not mutually exclusive. For example, a factory which has received several warnings may face other sanctions, such as a reduction in orders or, ultimately, termination of the manufacturing agreement.

### **3.1 Stop Work Notices**

Where it is warranted by the circumstances, the SEA Team may issue a temporary stop work notice, requiring a Business Partner to suspend operations at a factory until certain

requirements are met. The SEA Team may issue a stop work notice where:

- 1) incidents or breaches of workplace health and safety are life threatening or likely to lead to injury of workers, or which have the potential for such consequences; or
- 2) manufacturing operations have significant negative consequences for the environment, or which have the potential for such consequences.

Effectively, this means that SEA may instruct the factory to shut down (or 'power-down') the relevant production line(s) or production areas until the danger to workers, or other significant harm, is removed. Such action will only be taken by the SEA Team in extremely dangerous or serious circumstances, with a proper regard for balancing the production schedule against the risk associated with not issuing the notice.

The SEA Team has designated staff, qualified and expert in the area of health and safety, who will have the authority to issue a stop work notice if they are on site. All other team members are required to contact and consult with the health & safety experts before issuing a stop work notice. In all cases, the SEA Team will first consult the adidas Group Operations/Sourcing staff and factory management before stopping production. For practical reasons, and due to the nature of the extreme conditions that would require a stop work notice to be issued, notice will be given to management verbally in the first instance. However, a written record of the case will then be made by the SEA Team member issuing the notice and provided to all relevant parties.

### ***3.2 Third Party Investigation***

A third party investigation may be recommended where there are persistent or repeated breaches of the Standards requirements at the same manufacturing site or group of factories, and it has become a matter of public interest. In such cases where the SEA Team has been unable to influence management over an extended period, prior to termination being recommended, an independent, third party monitor may be invited to:

- investigate the causes of non-compliance;
- evaluate the impact of such non-compliance on the workforce; and
- recommend a plan of remediation.

In most cases, the third party monitor will choose to publish its findings and recommendations. The adidas Group also will be required to make public disclosure in relation to the factory's response and development of action plans and other steps to remedy poor compliance with the Standards.

### ***3.3 Review of Orders***

In cases of proven non-compliance, or where the SEA Team has issued a stop work notice or warning to a Business Partner, the SEA Team may recommend a review of orders. The adidas Group Operations/Sourcing staff may then choose to reduce or relocate current orders, or temporarily suspend any new orders being placed with the Business Partner. Such action would be appropriate in the following cases:

- where the non-compliance relates to excessive working hours;
- where workers have complained of unreasonable production targets or excessive pressure being exerted by supervisors on the factory floor; or
- where it is determined that the factory has misrepresented its capacity to complete and

deliver the product on time, regardless of whether the adidas Group is the sole 'buyer' at the factory.

### **3.4 Financial Contributions & Project Work**

In addition to its auditing and monitoring work in the factories of our Business Partners, the SEA Team is engaged in a number of projects aimed at making compliance more sustainable. The projects are diverse and cover a range of issues, from the development of a mechanism to establish fair wage levels, to occupational health education and training for factory clinic staff, to the implementation of human resources management systems, and best environmental practices in facilities that are more sophisticated in their management of environmental impacts. The SEA Team funds these projects internally from the budget allocated to consultancies and project work on an annual basis.

Where poor Standards performance in a specific area results in the need to establish a plan of remediation involving project work, third party consultants or monitors, or local NGOs, the Business Partner will be expected to fund the remediation work and contribute to the costs of any external consultant. Examples of such work are provided below:

- Where there is no adequate grievance process or system of appeal against unreasonable or unfair disciplinary action – an independent body may be established with a local project partner to act as a center for receiving worker complaints and to assist management in building the proper grievance systems within the human resources or personnel departments.
- Where there is no effective management-worker communication or the industrial relations in the factory are very poor – the development and delivery of appropriate training modules for management and union officers (or other worker representatives) by local arbitration institutions, the ILO or other experts in the industrial relations area.
- Where the health of factory workers is particularly poor or there is an unusually high incidence of chronic disease (e.g. tuberculosis, anemia, 'gray lung') – immediate health checks and medical assessment of all employees by local medical professionals and a thorough review of factory clinic capacity, procedure and treatments.
- Where there is severe contamination or pollution of the local environment due to improper or uncontrolled manufacturing processes – an immediate environmental impact assessment and, where appropriate, clean-up operation.

### **3.5 Warning Letters**

A warning letter is a written notification that, in the opinion of the SEA Team, a breach of the Standards has been committed (or is continuing) and that inadequate action has been taken by management to remedy the non-compliance. A record of warning letters issued by the SEA Team will be maintained and such letters will be referred to in any subsequent recommendation to terminate the manufacturing agreement. On any given issue, three warning letters will usually result in immediate recommendation to terminate.

The SEA Team will consider the following factors in deciding whether or not to issue a warning letter:

- the effect of the non-compliance on the workforce;
- the circumstances leading to the non-compliance;

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- the intent of the Business Partner (either at the individual factory level or at a group/corporate level);
- the history of Standards performance at the factory;
- the attitude of the Business Partner in discussions with the SEA Team regarding Standards requirements;
- any remedial steps taken to address the non-compliance.

These factors are not exhaustive, and those which are relied on to issue the warning will vary from case to case. It is not simply a matter of weighing up the number of factors for and against the Business Partner in respect of its Standards performance. The SEA Team will decide how important each factor is, given the specific circumstances, and will make an overall assessment before reaching a final decision. A warning will only be issued where the SEA Team believes that all other avenues of dialogue with the factory, such as meetings, have been explored and have not yielded any result.

### **3.6 Termination of Manufacturing Agreements**

The SEA Team recognises that recommending termination is a serious matter that should only be done after full consideration of all the consequences, especially any impact on the workforce. A decision to terminate must be discussed and agreed with senior adidas Group Operations/Sourcing management.

Either in the case of identification of a Zero Tolerance matter, or as a matter of last resort, where all other options have been exhausted and a Business Partner is still unwilling or unable to comply with the Standards, we will recommend termination of the manufacturing agreement.

## **Part 4 - Notes & Terms**

1. This Guideline will be updated from time to time and Business Partners will be notified of any significant changes in the approach of the SEA Team to sanctions and termination procedures.
2. Business Partner means any contractor, subcontractor, supplier or other person or organisation with whom the adidas Group has signed a manufacturing agreement.
3. In the Guideline, the term remediation refers to the process of resolving any non-compliance with the Standards, identified by the SEA Team. Usually, the remediation process involves the Business Partner implementing the suggested actions in the SEA labour and HSE action plans. The action plans are created following a factory audit by the SEA Team, and contain information about the non-compliance and negotiated timelines for carrying out remediation activities.
4. In the Guideline, the term enforcement refers to those actions which the adidas Group may take against a Business Partner who is unwilling or incapable of carrying out remediation.